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Argentina

LEGAL MEMORANDA

EDITOR'S NOTE

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ARGENTINA

The following is a brief summary of recent legislative developments in Argentina

ARGENTINA: NEW MEASURE TO DEFEAT THE FINANCIAL CRISIS

The devaluation of the Mexican peso in December of last year had repercussions on and notably worsened the emerging markets' economies, demanding accelerated solutions to avoid falling behind Mexico.

Argentina began to resist the inevitable, suffering of a slow but steady drain of liquidity from its monetary system. Furthermore, there was strong pressure for exchange rate adjustments, which would have meant the abandonement of the "Convertibility" Rule (The "Convertibility" Rule establishes that the Central Bank must always stand ready to provide U.S. dollars for peso currency surrendered at the rate of 1:1, until the monetary base of reserves and bonds is exhausted. At that point in time, under the same law, the Central Bank is forbidden from providing any additional credit). The tighter monetary conditions, imposed by the Mexican crisis and the fiscal policy compelled by the Convertibility Rule, moved the Argentine government to put a battery of new measures into effect. That is to say, a new try to re-obtain a fiscal surplus in the absence of non-bank domestic or external financing and because of scarce domestic credit from a banking system shrunken by the capital flight during the first quarter.

In order to add liquidity to the banks, which have been losing disproportionately large shares of deposits, and to generate credit and guarantee the banking system's deposits, the Argentine government recently amended the Central Bank's charter and created a Fiduciary Fund for private bank capitalization.

In addition, the Argentine government, assisted and encouraged by the most representative economic groups, banks and business institutions, launched the so-called *Bono Argentina*. The Bond was issued to raise money for the creation of the above mentioned Fiduciary Fund.

What follows is a summary of the above mentioned changes.

Amendments to the Central Bank's Charter

The existing official guaranty for banks' deposits, administered by the Central Bank, was increased to cover up to $5,000 (pesos or U.S. dollars, indistinctly) per person. Through this guaranty, depositors will have the exclusive right to be repaid out of the so-called *Encajes*. *Encajes* are mandatory reserves that each institution is required to keep tied up at the Central Bank.

In addition to the official guaranty, a private guaranty will be created. Once in place, it will be onerous, mandatory and exclusive for deposits higher than $5,000 up to a maximum to be determined (which is expected to be of $30,000 pesos or U.S. dollars, indistinctly). In principle, the private guaranty will be formed by funds contributed by all the private banks of the system.

Suspension terms for troubled financial entities are extended from sixty to ninety days. Once this term elapses, the authorization to operate could be revoked if the troubled bank is not in a position to do so normally.

The new charter authorizes the Central Bank to obtain loans from entities such as the International Bank of Basle, the U.S. Federal Reserve, the Bank of England, the Bundesbank, the IMF or the World Bank. However, the Central Bank will not be able in any case to affect the country's reserves backing the monetary base.

In addition, it authorizes the Central Bank to provide extraordinary financing to troubled entities, receiving as collateral its assets and its shareholders' equity.

The Central Bank will be able to sell, transfer or assign to other institutions credits acquired from troubled banks. The entity absorbing those assets would be taking control over the troubled entity.

Should the Central Bank be obliged to close a bank, two alternatives for protecting deposit-holders haven been established. One sets forth the mandatory reduction or increase, as the case may be, of the troubled bank's capital and reserves in order to absorb losses, or to fulfill minimum capital requirements. The other alternative foresees the exclusion and transfer of the troubled bank's assets to other banks. The funds received in such manner will be used by the troubled bank to cover its deposits.

Shareholders of financial entitites could be penalized for concealing their bank's connections with foreign entities in which they hold controlling stakes, if they use them to carry out off shore operations from Argentina.

Fiduciary Fund for Private Banks' Capitalization

The Fund's objective is to capitalize and finance the mergers and acquisition process of private banks which are not strategically positioned to compete within the system, are undercapitalized or have severe liquidity and structural problems.

The Fund will carry out the capitalization of the private banking system through: (i) the subscription and integration of capital contributions or convertible bonds; (ii) the purchase and sale of bank's share; or (iii) the acquisition, sale and transfer of banks' assets and liabilities.

The Fund's resources amount approximately to U.S. $2.5 billion, gathered through *Bono Argentina.* Other resources, such as funds provided by international multilateral institutions and operation revenues, would be available to the Fund.

The Fiduciary Fund will be managed by an Executive Committee formed by five members representing the Ministry of Economy, the Central Bank, and the local and foreign major subscribers to the *Bono Argentina*. The Executive Committee will be in charge of developing a plan or mechanism for selling the acquired assets and establishing the applicable regulations and time tables to be executed in each case.

The shares or interest acquired or received by the Fund will be sold through public auctions and public or private tender offers within the capital markets. Property and other assets will be publicly or privately auctioned. Fiduciary funds will be deposited at qualified institutions approved by the Central Bank for the custody of international reserves.

The Fiduciary Fund is expected to fulfill its object within a period of two years. At that time, the Central Bank will consider, if necessary, the replacement of the Fund by an institution with similar objectives. Such institution would also be in charge of managing the above-mentioned guaranty of the deposits' system.

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